In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 478

E. TAYLOR CHEWNING and CAROLINE M. CHEWNING, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The issue in this case is whether § 1231 of the Internal Revenue Code of 1954 requires petitioners to offset a casualty loss against certain gains, as the Commissioner contends, or whether, as petitioners contend, they may deduct the casualty loss against their ordinary income.

Petitioners, in 1960, sustained an uninsured $8,500 loss to their personal residence resulting from snow storm damage to certain boxwood bushes located on

the premises. In the same year, they realized a $13,710 gain on the sale of breeding cattle which had been held by them for the production of income. On their 1960 tax return they treated the gain from the sale of cattle as capital gain under the provisions of § 1231(a) of the 1954 Code. They treated the casualty loss as an ordinary loss under the provisions of § 165(c)(3) of the 1954 Code. (Pet. 2-3.)

The Commissioner took the position that the casualty loss to petitioners' home, being a partial involuntary conversion of a capital asset held for more than six months and not held for the production of income, fell within § 1231, and that it thus had to be netted against the gain from the sale of the breeding cattle, with the excess of the gain over the casualty loss being treated as capital gain. The Tax Court sustained the Commissioner's determination in an opinion that was reviewed by the full court without dissent, and the Fourth Circiut affirmed. (Pet. 3.)

Section 1231 of the 1954 Code (Appendix, *infra*, pp. 5-6) provides, in general, that gains and losses from certain types of transactions shall be netted against each other, and that if the net result is a gain, it will be taxed as capital gain, but if the net result is a loss, it will be treated as an ordinary loss. The transactions covered by Section 1231 include (1) all gains and losses from "sales or exchanges of property used in the trade or business" and (2) all gains and losses from "the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure * * *) of property used in the

trade or business, and capital assets held for more than 6 months into other property or money."

Prior to 1958, § 1231 made no express reference to wholly uninsured casualty losses, and there is no indication that Congress had ever thought of them as a special class. In that year, however, Congress carefully considered whether uninsured casualty losses fell within § 1231. It amended the section to exclude from its coverage uninsured casualty losses to property (1) used in a business or (2) held for the production of income.[1] The Committee Report on the legislation stated (1) that before the amendment *all* uninsured losses were covered by § 1231, and (2) that after the amendment § 1231 would continue to cover uninsured casualty losses *on property held for personal use* but would thereafter not cover uninsured losses on property held for use in a business or for the production of income.[2] Therefore, regardless of what the law was before 1958, it is clear that after the 1958 amendment § 1231 covers uninsured casualty losses to property held for personal use for more than 6 months.

Petitioner argues that the instant decision conflicts with *Maurer* v. *United States*, 284 F. 2d 122

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[1] Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, § 49(a). See App., *infra*, p. 6. This amendment was effective as to all tax years beginning after December 31, 1957. *Id.*, § 49(b); see also Treas. Reg. § 1.1231-1(e)(2), App., *infra*, p. 7.

[2] S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 74-75, 203-204 (1958-3 Cum. Bull. 922, 995-996, 1124-1125) (App., *infra*, pp. 7-9).

(C.A. 10). However, that case involved a pre-1958 casualty loss. Therefore, the language of the statute at the time of the transaction involved in *Maurer* was materially different from the statute here in question. There is no conflict among the courts of appeals as to the meaning of § 1231 as amended in 1958.

Moreover, the issue here is identical with that in *Morrison* v. *United States*, 355 F. 2d 218 (C.A. 6), in which the Court of Appeals for the Sixth Circuit reached precisely the same result as the Court of Appeals for the Fourth Circuit in this case. The taxpayer in the *Morrison* case filed a petition for a writ of certiorari, making substantially the same arguments as are set forth by the petitioners in the instant case. This Court, on June 13, 1966, denied the petition. 384 U.S. 986.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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SEPTEMBER, 1966.

APPENDIX

Internal Revenue Code of 1954:

SEC. 1231. [as amended by Sec. 49(a), Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606]. PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS.[1]

(a) *General Rule.*—If, during the taxable year, the recognized gains on sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For purposes of this subsection—

(1) in determining under this subsection whether gains exceed losses, the gains described therein shall be included only if and to the extent taken into account in computing gross income and the losses described therein shall be included only if and to the

[1] Material added by the Technical Amendments Act of 1958 (*infra*, p. 6) shown in italics.

extent taken into account in computing taxable income, except that section 1211 shall not apply; and

(2) losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft.[2]

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(26 U.S.C. 1231.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.1231-1. *Gains and losses from the sale or exchange of certain property used in the trade or business.*

* * * * *

(e) *Involuntary conversion.* — (1) *General rule.* * * * Losses upon the complete or partial destruction, theft, seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there is a conversion of the property into other prop-

[2] See note 1.

erty or money unless subparagraph (2) of this paragraph applies. For example, if a capital asset held for more than 6 months, with an adjusted basis of $400, but not held for the production of income, is stolen, and the loss is not compensated for by insurance or otherwise, section 1231 applies to the $400 loss.

(2) *Certain uninsured losses.* Notwithstanding the provisions of subparagraph (1) of this paragraph, losses sustained during a taxable year beginning after December 31, 1957, with respect to both property used in the trade or business and any capital asset held for more than 6 months and held for the production of income, which losses arise from fire, storm, shipwreck, or other casualty, or from theft, and which are not compensated for by insurance in any amount, are not losses to which section 1231(a) applies. Such losses shall not be taken into account in applying the provisions of this section.

* * * * *

(26 C.F.R., Sec. 1.1231-1.)

S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 74-75, 203-204 (1958-3 Cum. Bull. 922, 995-996, 1124-1125):

Under present law where there are uninsured losses on property as a result of its destruction, theft, seizure, requisition, or condemnation, such losses, in the case of property used in the trade or business or capital assets held for more than 6 months, are treated as section 1231 losses.

* * *

Where a taxpayer elects to be a self-insurer against casualty losses, there seldom is a con-

version into money or other property, as there would be if the destroyed property were insured. If this casualty loss were the only loss incurred during the taxable year by the self-insured person, he would be entitled to the full benefit of an ordinary loss deduction under section 1231, but where there are also 1231 gains, the casualty loss is partially or wholly offset against these gains which would otherwise be taxed as capital gains. * * *

* * * The provision added makes section 1231 inapplicable in the case of losses where the taxpayer is not compensated for the loss by insurance, if the loss arises from fire, storm, shipwreck, or other casualty or from theft. This treatment is to apply, however, only in the case of property used in the trade or business and in the case of capital assets held for more than 6 months and held for the production of income. * * *.

* * * * *

This section amends section 1231(a) of the 1954 Code by making it inapplicable to any loss in respect of which the taxpayer is not compensated by insurance in any amount if the loss arose from fire, storm, shipwreck, or other casualty, or from theft, and the loss occurred with respect to property used in the trade or business or a capital asset held for more than 6 months and held for the production of income.

Under Section 1231, uninsured casualty losses on depreciable property or real estate used in the trade or business or on capital assets must be aggregated with various other types of section 1231 gains and losses. * * *

Your committee has provided this section to separate certain uninsured casualty losses from the computation of section 1231 gain or loss, but only with respect to property used in the trade or business and capital assets held for the production of income which have been held more than 6 months. The amendment applies with respect to, for example, loss incurred as a result of the destruction of a taxpayer's oil tanks which he used for oil storage in his trade or business, but on which he was unable to obtain insurance. On the other hand, the amendment does not apply to loss arising from the destruction or theft of the taxpayer's uninsured personal automobile.

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